

STATE OF CALIFORNIA

Public Utilities Commission
San Francisco

M e m o r a n d u m

Date: August 21, 2003

To: The Commission
(Meeting of August 21, 2003)

From: Alan LoFaso, Director
Office of Governmental Affairs (OGA) — Sacramento

Subject: SB 118 (Bowen) Public Utilities Commission: conflict of interest
As amended June 19, 2003

Legislative Subcommittee Recommendation:

Summary: This bill would provide for automatic removal from office of a Public Utilities Commissioner who voluntarily acquires a financial interest in an entity regulated by the Commission.

Digest: Existing law, Article XII, Section I of the California Constitution, provides for a five-member Public Utilities Commission appointed by the Governor for staggered six-year terms. The Legislature may remove a Commissioner for incompetence, neglect of duty or corruption provided two-thirds of the membership of each house concurs.

Existing law, the "Political Reform Act", Government Code secs. 81000 et. seq., defines numerous conflict of interest violations applicable to state officers and penalties for those violations.

Existing law, P.U. Code sec. 303, provides that a Commissioner may not hold an official relation to, nor have a financial interest in, a person or corporation subject to regulation by the commission.

Existing law further provides that if a Commissioner acquires a financial interest in a corporation or person regulated by the Commission other than voluntarily, his or her office shall become vacant unless within a reasonable time he or she divests himself or herself of the interest (emphasis added). In People ex rel. Fdn. for Taxpayer and Consumer Rights v. Henry Duque, 105 Cal. App. 4th 259, 129 Cal. Rptr. 2d 298, 2003 Cal. App. LEXIS 38, the California Court of Appeals, First District, held that the remedy

of automatic removal from office in P.U. Code sec. 303 applies only to involuntarily acquisitions of a financial interest regulated by the Commission. The Court further held that the remedy of automatic removal from office does not apply to voluntary acquisitions.

Existing law also requires the Commission to adopt an updated Conflict of Interest Code and Statement of Incompatible Activities, by February 28, 1998, in a manner consistent with applicable law.

This bill would provide for automatic removal from office of a Commissioner who voluntarily acquires a financial interest in a corporation or person that the commissioner knows or should know is subject to regulation by the commission, his or her office shall immediately become vacant (emphasis added).

This bill would define “financial interest” to include those interests enumerated in Government Code sec. 87103(a)-(e)¹ (part of the Political Reform Act).

This bill would also require the Commission to adopt an updated Conflict of Interest Code and Statement of Incompatible Activities, by February 28, 2004, in a manner consistent with applicable law.

Analysis: SB 118 would expand the circumstances where Public Utilities Commissioners may face automatic removal of office to circumstances where that Commissioner acts voluntarily.²

1. Government Code sec. 87103 reads as follows:

87103. A public official has a financial interest in a decision within the meaning of Section 87100 if it is reasonably foreseeable that the decision will have a material financial effect, distinguishable from its effect on the public generally, on the official, a member of his or her immediate family, or on any of the following:

(a) Any business entity in which the public official has a direct or indirect investment worth two thousand dollars (\$2,000) or more.

(b) Any real property in which the public official has a direct or indirect interest worth two thousand dollars (\$2,000) or more.

(c) Any source of income, except gifts or loans by a commercial lending institution made in the regular course of business on terms available to the public without regard to official status, aggregating five hundred dollars (\$500) or more in value provided or promised to, received by, the public official within 12 months prior to the time when the decision is made.

(d) Any business entity in which the public official is a director, officer, partner, trustee, employee, or holds any position of management.

(e) Any donor of, or any intermediary or agent for a donor of, a gift or gifts aggregating two hundred fifty dollars (\$250) or more in value provided to, received by, or promised to the public official within 12 months prior to the time when the decision is made. The amount of the value of gifts specified by this subdivision shall be adjusted biennially by the commission to equal the same amount determined by the commission pursuant to subdivision (f) of Section 89503.

For purposes of this section, indirect investment or interest means any investment or interest owned by the spouse or dependent child of a public official, by an agent on behalf of a public official, or by a business entity or trust in which the official, the official's agents, spouse, and dependent children own directly, indirectly, or beneficially a 10-percent interest or greater.

2 . This memo does not address the question, also left unaddressed by the Duque Court, whether or not the question of removal of a Public Utilities Commissioner from office is a remedy reserved for the Legislature by the California Constitution, which may not be delegated to the judicial or executive branches.

The bill arises in response to the Duque court's reversal of a trial court ruling that would have removed former Commissioner Henry Duque for acquiring stock in Nextel—a Commission regulated wireless carrier—that was voluntarily purchased on his behalf by a broker. The Duque Court declined to find that the remedy of removal from office was applicable in that case on grounds of statutory interpretation. 105 Cal. App. 4th at 264-65.

In its holding, the Duque Court affirmed that sec. 303 bars a Commissioner from voluntarily owning an interest in a Commission regulated entity. Id. at 264. (Former Commissioner Duque paid a fine for this violation.) Finding a “critical gap in the language of the statute,” the Court identified voluntary acquisition of a prohibited interest as a circumstance that might give rise to grounds for impeachment of that Commissioner by the Legislature pursuant to the constitution. Id. at 265-66.

The Duque court also rejected an argument that sec. 303 impliedly provides for removal for office for voluntary acquisitions because these actions, by their nature, are a more serious offense. Id. at 267. The Court found this premise flawed because a Commissioner could inadvertently acquire an interest in a regulated entity in a circumstance, for example, in which an unregulated company recently acquired an interest in a regulated company. Id. This was not a particularly blameworthy act in the eyes of the Court. Id.

Opportunity to divest of the interest

The Duque court's reasoning here is relevant to SB 118's approach to penalizing voluntary acquisition of a financial interest. The inadvertent acquisition used as an example in this part of the decision could easily be viewed as involuntary because the hypothetical acquirer did not intend to acquire a financial interest in a Commission-regulated entity (because, in the example, the interest is not Commission-regulated at the time the actor intends to acquire it). However, apparently because the acquirer in the hypothetical acts voluntarily to acquire the interest, notwithstanding the regulatory status of the interest, the Duque court identified this acquisition as voluntary.

Therefore, the Duque court appeared to believe that a financial interest could be voluntarily acquired and subsequently become a prohibited acquisition, giving rise to removal from office. In that case, the provisions in the current law allowing a Commissioner to avoid removal by divesting himself or herself of the interest within a reasonable time should be applicable to at least some voluntary acquisitions. Therefore, the bill should be amended to give a Commissioner a reasonable time to divest himself or herself of the interest in cases where the Commissioner did not have actual or constructive knowledge that the Commission regulated the interest.

Limitation – actual or constructive knowledge

SB 118 would provide that removal from office for voluntary acquisition only occurs where the Commissioner knows or should know that the entity is regulated. The

Commissioner's actual knowledge that the interest is regulated or a court's subsequent determination that a reasonable person should know that the interest is regulated (constructive knowledge) would give rise to removal. Therefore, acquisition of an interest where a reasonable person should not have knowledge that it is Commission-regulated would not give rise to removal from office.

Applying a remedy as serious as automatic removal from office may be too severe for a violation that amounts to negligence. Other statutes providing for removal from office of a state official require a more serious act to trigger the serious remedy of removal from office.³ No party disputes or in any way suggests that Commissioners should not be prohibited from having an financial interest or an official relationship with any Commission-regulated entity.

However, the negligence standard may result in Commissioners being removed from office for truly insignificant acts that may not be appropriate in light of the wide range of entities that the Commission currently regulates.

The Commission regulates substantially more entities than it did when P.U. Code sec. 303 was originally enacted. No longer does the Commission only regulate large, easily identifiable entities. Moreover, many entities regulated by the Commission are owned by holding companies with names that differ from the Commission-regulated entity.

In addition to "public utilities", the Commission regulates or exercises some degree of oversight over many entities, such as mobile homes, various types of carriers, and prepaid telephone debit cards.

Many of these entities are owned by businesses whose primary business is not regulated by the Commission. (For example, a large retail chain may have a charter party carrier license for a parking lot shuttle.) Should a commissioner be removed from office for owning stock in a publicly-traded retail chain possessing a licensed parking shuttle? Is it reasonable to expect a Commissioner to know that such an entity has a Commission license for a discrete activity? Is it good policy to subject a Commissioner to jeopardy of losing his or her office by leaving it to a court to make that judgment?

Again, in none of these cases, is it suggested that other penalties for violating the ban on acquiring a financial interest or official relationship to a Commission-regulated entity should not apply.

Recent Amendments

SB 118 was recently amended to apply provisions of the Political Reform Act (Gov't Code sec. 87103) to define the term "financial interest" as used in sec. 303. P.U. Code sec. 3030(a) prohibits a PUC Commissioner from having an "official relation to" or "a

3. See, e.g., Government Code sec. 15626, which provides for automatic removal from office of a Member of the Board of Equalization who accepts a contribution of \$250 or greater and fails to recuse himself or herself from voting on an adjudicatory matter affecting the contributor within 12 months of receiving the contribution.

financial interest" in entities subject to regulation by the Commission. It is not clear how Gov't Code section 87103(b) (dealing with real estate) has any nexus to entities subject to regulation by the Commission. Therefore, the reference to subdivision (b) of sec. 87103 should be deleted.

Subdivision (d) of sec. 87103 deals with "official relations," not "financial interest." Accordingly, the language in proposed subdivision (c) of sec. 303 should be revised to say that "For purposes of this section 'financial interest' means those interests enumerated in subdivisions (a), (c), and (e) of Section 87103 of the Government Code and 'official relation' means those relationships enumerated in subdivision (d) of Section 87103 of the Government Code."

The immediately preceding suggestion also corrects another problem with the language currently in the bill. The goal of any amendment should be to clarify what interests are and are not prohibited. The current language says that "financial interest" "includes" the enumerated interests. Thus, the current bill does not help Commissioners in understanding what interests are too remote to be a problem. Therefore, the language should be tightened to state that the term "means" the same as the provisions in sec. 87103.

Conflict of Interest Code/Statement of Incompatible Activities

SB 118 would also require the Commission to update its Conflict of Interest Code and Statement of Incompatible Activities by February 28, 2004. Current law required the Commission to update these documents by February 29, 1998. The Commission updated its Conflict of Interest Code by the earlier date, but not the Statement of Incompatible Activities.

The Commission's Conflict of Interest Code was last amended in September 2001.⁴ On July 10, 2003, the Commission instituted a rulemaking to update its Conflict of Interest Code (R.03-07-007). Therefore, requiring this in statute is unnecessary.

Commission staff indicates that the Statement of Incompatible Activities must be submitted to the Department of Personnel Administration for approval. Because that is a necessary step for completing this document, the bill should be amended to reflect that step in the process.

The author's office has indicated that this provision may be dropped from the bill.

Summary of suggested amendments

1. Articulate the range of "Commission-regulated" entities in which a financial interest or official relationship should trigger removal from office.

4. See D. 01-09-019.

2. Clarify that a Commissioner may have a reasonable time to divest of a financial interest where it was voluntarily acquired, but not actually or constructively known to be a Commission-regulated interest.
3. Clarify that, if the Political Reform Act is to be used to define “financial interest”, that those provisions provide the definitions.
4. Technical amendments governing the revised Conflict of Interest Code and Statement of Incompatible Activities.

LEGISLATIVE HISTORY

Assembly Approps.: 23-0 (do pass) (7/2/03)
Assembly U&C: 13-0 (do pass as amended) (6/16/03)
Senate Floor: 37-0 (Pass to Assembly) (5/22/03)
Senate E.U.&C.: 8-0 (do pass) (4/22/03)

SUPPORT/OPPOSITION

Support: Foundation for Taxpayer and Consumer Rights; Utility Consumers' Action Network (UCAN).

Opposition: None on file.

LEGISLATIVE STAFF CONTACT

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Date: August 19, 2003

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Attachment

BILL LANGUAGE:

BILL NUMBER: SB 118 AMENDED
BILL TEXT

AMENDED IN ASSEMBLY JUNE 19, 2003
AMENDED IN SENATE MAY 7, 2003
AMENDED IN SENATE APRIL 21, 2003

INTRODUCED BY Senator Bowen

FEBRUARY 3, 2003

An act to amend Section 303 of the Public Utilities Code, relating to the Public Utilities Commission.

LEGISLATIVE COUNSEL'S DIGEST

SB 118, as amended, Bowen. Public Utilities Commission: conflict of interest.

Under existing law, no person may be appointed to or hold the office of public utilities commissioner who also is employed by, holds any official relation with, owns stocks or bonds of, or is in any manner pecuniarily interested in, any corporation or person that is subject to regulation by the commission. Existing law requires the commission to adopt an updated Conflict of Interest Code and Statement of Incompatible Activities, by February 28, 1998, in a manner consistent with applicable law.

This bill would provide that the office of any commissioner who voluntarily acquires a financial interest , as defined, in a corporation or person that the commissioner knows or should know is subject to regulation by the commission, will immediately become vacant, and would require the commission to adopt an updated Conflict of Interest Code and Statement of Incompatible Activities, by February 28, 2004, in a manner consistent with applicable law.

Vote: majority. Appropriation: no. Fiscal committee: yes. State-mandated local program: no.

THE PEOPLE OF THE STATE OF CALIFORNIA DO ENACT AS FOLLOWS:

SECTION 1. Section 303 of the Public Utilities Code is amended to read:

303. (a) A public utilities commissioner may not hold an official relation to, nor have a financial interest in, a person or corporation subject to regulation by the commission. If any commissioner voluntarily acquires a financial interest in a corporation or person that the commissioner knows or should know is subject to regulation by the commission, his or her office shall immediately become vacant. If any commissioner acquires a financial interest in a corporation or person subject to regulation by the commission other than voluntarily, his or her office shall become vacant unless within a reasonable time he or she divests himself or herself of the interest.

(b) The commission shall adopt an updated Conflict of Interest Code and Statement of Incompatible Activities, by February 28, 2004, in a manner consistent with applicable law.

(c) For purposes of this section, "financial interest" includes those interests enumerated in subdivisions (a) through (e), inclusive, of Section 87103 of the Government Code.